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Family Trust Creation: Understanding the Basics A trust comes into play when one person, known as the trustee, holds and manages assets on behalf of another individual, referred to as the beneficiary. A family trust is specifically designed to benefit members of your immediate family, including future generations like grandchildren. The primary goal of setting up a family trust is to transfer ownership of your assets into it, ensuring that, legally, you no longer possess them personally. However, through this arrangement, you can still exert control and enjoy the benefits from these assets. There are two ways to establish a family trust: during your lifetime (via a declaration within a trust deed) or upon your passing (through your will). This guide focuses on creating trusts while you're alive and explores the advantages they offer for your benefit in life. Once you grasp the basics of trust formation from reading this article and related content, you may want to prepare some necessary documents yourself. New Zealand LegalDocuments offers cost-effective trust document templates that can be helpful in this process. Like any other type of trust, a family trust requires certain fundamental elements: 1. **The Settlor**: This is the individual who sets up the trust, usually also being the person currently holding the assets to be transferred into it. In most cases, this person will also serve as one of the trustees. 2. **Trustees**: These are individuals responsible for managing and administering the trust according to its deed. Typically, the settlor is allowed to act as a trustee but often appoints an independent trustee, such as a lawyer or accountant, to avoid the perception that they retain control over the assets, which could invalidate the trust with Inland Revenue. 3. **Beneficiaries**: These are the individuals who may benefit from the trust. With family trusts, these beneficiaries usually include all members of your immediate and extended family (future generations). They are considered "discretionary" beneficiaries, a key aspect that distinguishes family trusts from other types of trusts. A family trust, once set up, can essentially make its beneficiaries, known as "fixed" trusts, ineligible for any benefits from the trust itself. Instead, the trustees have the authority to select which of these beneficiaries will receive the assets' benefits. This selection process allows the trustees to determine who is most deserving at any given time. The trust deed, a crucial document, outlines the settlor's wishes and establishes the trust. It designates the trustees, specifies their powers and duties, names the beneficiaries, and sets forth rules for administering and managing the trust. To be effective and comply with tax regulations, this document typically requires careful drafting and may be lengthy. A family trust's primary goal is to transfer significant assets from personal ownership to the trust itself, thereby achieving "personal poverty" while still benefiting from the trust as a beneficiary. This strategy can help protect assets from various threats, such as claims by business creditors or ex-spouses/partners under the Property (Relationships) Act. To maximize the benefits of a family trust, it is advisable to transfer significant assets into the trust by age 55 at the latest. People in their forties and fifties should consider the advantages of establishing a family trust. For instance, if an individual aged 70-80 were to gift $200,000 to a trust, they would need to live for eight more years before forgiving the debt at $27,000 annually and then five more years to qualify for government rest-home subsidies. Given their advanced age, it is likely that they would require care before these time limits expire and the gifts are completed. You don't have to transfer your assets to a trust by age 55; it can still provide benefits as explained below: "Rest-Home Subsidies & Gifts to Family Trusts /Can a trust help even when rest home care is impending?" The costs of maintaining a trust include annual accounts, tax returns, and compliance with the Inland Revenue Department. Establish that the trust's benefits outweigh its costs before setting it up. What assets can be transferred? Almost any asset can be held by the trust, including real estate, motor vehicles, valuable artwork, household items, and company shares. You should consider transferring appreciating assets into the trust before depreciating ones like motor vehicles. Get expert advice on this. The steps for transferring assets to a family trust are: choose the asset, usually starting with the family home; obtain valid valuations; and transfer ownership in exchange for a debt through an Agreement for Sale and Purchase. The trust must pay you the full value of the asset. You've set up a trust with minimal funds ($10) and can't afford to purchase the property. To get around this, you'll lend the trust $200,000 interest-free, effectively canceling out the loan. This transaction won't require a bank loan, as it's just a paper deal secured by a Deed of Acknowledgement of Debt. The catch is that even though the asset has been transferred to the trust, it still owes you an equivalent amount. To get rid of this debt and achieve "personal poverty" in relation to the property, you'll need to forgive the debt through a gifting program over several years. This process involves partial forgiveness stages, as lump-sum forgiveness would incur gift duty. Once the debt is fully forgiven, the trust will own the asset, but you can still benefit from it as a beneficiary. The gifting program: Forgiving the debt to the trust requires careful planning, as New Zealand tax laws limit annual gifts without incurring duty to $27,000 per person or $54,000 for a married couple. Gifts exceeding this amount trigger gift duty at varying rates. To avoid gift duty, you'll need to forgive the debt in stages, rather than all at once. This process of phased forgiveness is crucial to achieving "personal poverty" and transferring assets to the trust without incurring excessive taxes. "gift-giving initiative". For instance, consider a couple, John and Marsha, who establish a family trust. Jointly owning a mortgage-free house, they plan to transfer the property to the trust. Following an appraisal by a Real Estate Agent, valuing the house at $180,000, and a current market valuation from Valuation New Zealand of $170,000, the couple opt for the lower market value of $170,000. They then enter into a Sale and Purchase Agreement with the trustees of the trust to sell the house for $170,000. Upon settling the transfer, the trust pays $170,000 to the couple, receiving an interest-free loan of the same amount in return. At this point, the trust owns the house, but the couple still possesses a personal asset worth $170,000 (the loan). The couple initiates debt forgiveness by creating a Deed of Partial Forgiveness of Debt. In the first year, John and Marsha each forgive $27,000 of the debt owed to them by the trust, totalling $54,000, reducing the trust's debt to $116,000. They continue this process over four years, ultimately forgiving the entire debt. The trust now fully owns the house, with the couple owing no debt. If required, they can legally declare non-ownership of the house. Regarding IRD notification, if gifts exceed $12,000 within a 12-month period, you must submit an IR 196 "Gift Statement" form, accompanied by a copy of the deed of forgiveness. An alternative approach is the "lease for life". Setting up a family trust has become increasingly popular, with some people opting for a lease-for-life approach instead of selling full ownership to the trust. This involves granting themselves a life interest in an asset, such as the family home, before transferring it to the trust. By doing so, the settlors essentially rent the house back from the trust, paying rent on what's left of the ownership rights after their death. This approach is different from the conventional method where the settlors sell full ownership to the trust and then lend them money for the sale. With a lease-for-life setup, the trust doesn't get outright ownership of the house, and the settlors' right to live in it comes from their own lease rather than one given by the trust. The primary goal is to reduce the value of the asset being transferred to the trust. By creating a life interest, the property's worth decreases significantly since someone else wouldn't be able to use it for their lifetime. For instance, if a woman grants herself a 60-year lease on a $200,000 house, its market value could drop to $80,000. However, this approach has significant drawbacks and should only be used in very specific circumstances, including the property's value, the age of the settlors, and the likelihood of the trust needing to sell the asset. When considering transferring property to a family trust, it's crucial to seek legal advice to ensure a smooth process. The nature of the property, such as a beach property, might impact the transfer. If you're concerned about a mortgage on the property, rest assured that it doesn't necessarily create a barrier to transferring the asset to a trust, but it may make the transaction more complex and costly. It's also important to note that certain circumstances can lead to setting aside a transfer of assets or gifts. For instance, if your intention is to defraud creditors, or you're adjudged bankrupt within two years of making the gift, the payment can be taken back. Similarly, transfers of assets can be set aside if they defeat the rights of spouses or de facto partners to share in relationship property. In the context of rest home subsidies and gifts to family trusts, asset-testing is crucial for qualifying for a Residential Care Subsidy. To qualify, you must have no home unless a dependent spouse, partner, or child still resides there, and your cash savings must be below a certain threshold. The asset threshold has increased significantly over the years, with further increments every July. However, by 2010, the asset limit for a single person will only be $200,000, with any assets exceeding that amount not eligible for the subsidy. For more detailed information on transferring property to a trust or setting aside transfers of assets and gifts, it's recommended to seek legal advice. The funds transferred to a trust can cover rest-home fees, making it an attractive option for asset protection. Additionally, there are other compelling reasons to consider transferring your assets to a trust, including avoiding Government asset-testing. Keep in mind that you can pre-pay a funeral up to $10,000 without affecting the calculation. When applying for the Residential Care Subsidy, you'll need to declare any gifts made within the previous five years. Forgiving debts under a family trust arrangement is considered a gift, so be mindful of this when calculating your assets. If you've gifted more than $5,000 per year over the past five years, the excess will still be assessed as part of your current assets. However, you'll receive a deduction for each year since the gift was made, effectively reducing the amount considered part of your personal assets. Work and Income can investigate gifts made beyond the previous five-year period if they suspect a benefit or subsidy is being sought. It's crucial that a trust is properly administered, with accurate records kept and assets managed according to the trust's terms. Failure to do so could result in the trust being deemed invalid by the Inland Revenue Department or other creditors. Legal advice is crucial. Poor guidance can result in financial waste. You'll need an IR 196 "Gift Statement" form from Inland Revenue whenever you give away more than $12,000 within a year. If you're forgiving debt to a family trust and the reduction exceeds $12,000, you must fill out this form. Attach two copies along with a copy of the deed of forgiveness. Trusts are a popular way to protect property and manage assets. A trust is created when someone transfers property to others, who then use it for specified purposes, usually benefiting certain individuals. Think of a trust as a relationship between trustees and beneficiaries that requires the former to act in the best interest of the latter. The terms and parties involved are usually outlined in the trust deed or will. Trusts can be set up for charitable causes like education or to benefit specific family members. The specifics vary greatly depending on the trust's purpose. New Zealand's Trusts Act 2019 applies to all express trusts, including family trusts. If you haven't already, review your trust deeds since this legislation took effect on January 30, 2021. This guide focuses on family trusts but much of the information also pertains to other types. People often establish family trusts to protect assets for their loved ones by transferring ownership to a trust, allowing them to take higher-risk occupations or ventures without jeopardizing those assets. A family business or farm can be transferred intact to the next generation, ensuring some assets remain for other relatives when one or more members require nursing home or hospital care. This helps protect family members and the business from potential property disputes or will contesting claims. A trust can also be used to manage assets for someone who is unable to do so themselves due to age or infirmity, assisting with estate administration. Assets are transferred into a trust before death, which can change tax liability, though the amount of tax payable may vary and should be reviewed regularly. The main parties involved in a trust include: - **The Settlor**: This is the person (or people) who initially transfers property, such as cash or assets worth at least $1, to the trustees. - **The Trustees**: A trust typically has two or more trustees chosen by the settlor for their ability to manage the trust prudently. The settlor can choose to be a trustee themselves and may also appoint an unrelated professional, like a lawyer, accountant, or corporate trustee. - **The Beneficiaries**: These are the individuals (named or grouped) for whom the trust has been established. There are usually two types of beneficiaries: discretionary beneficiaries and final or ultimate beneficiaries. - **Discretionary Beneficiaries** have a right to be considered by the trustees for payments from the trust but do not automatically receive them. - **Final or Ultimate Beneficiaries**, on the other hand, have a legal right to the trust property once it concludes. They are often named and may include the settlor's children with provision for grandchildren if a child dies before the trust finishes. The maximum duration of a trust was limited in the past but now has no specific limit, allowing more flexibility in estate planning. For over 80 years, certain trusts have had a specific duration, but with the introduction of the Trusts Act in 2019 and its implementation on February 1, 2021, this has changed. The new law allows for trust durations up to 125 years. However, existing trusts settled before the new act may not be eligible for the extended lifespan unless their terms specifically allow it. It's crucial for older trust holders to consult with a lawyer regarding their options. The Trust Deed usually empowers the settlor or other individuals to appoint and remove trustees. The Trusts Act outlines who can perform these tasks if the deed doesn't specify this or if the person with the power is unable to exercise it. As the property owners, trustees have the same rights as property owners, including holding assets, raising mortgages, and managing bank accounts. Assets can be transferred into trust at any time through gifting or sale. The settlor typically transfers assets into trust or acquires them from another party. Prior to the repeal of gift duty in 2011, it was common for settlers to sell assets to trustees if there were no funds available. The debt would then be forgiven gradually up to $27,000 per year. The value of sold assets belongs to the trust, not the settlor personally. Similarly, income generated from trust assets usually belongs to the trust and not the settlor. With the repeal of gift duty in 2011, it's now possible for settlers to transfer assets into trust without incurring duties. This means that: * Settlers can forgive any outstanding debt owed by trustees for past asset sales. * Settlers can transfer assets into trust through gifting rather than sale. However, caution is advised regarding these new options. The role of trustees is to decide which payments from income or capital are to be made and distributed among beneficiaries. If there's a debt owed by the trust, creditors can demand payment, but if the settlor has a repayable debt for the initial purchase of assets, they can request repayment at any time. Payments from the trust to the settlor may be tax-exempt. Income is typically taxed in the hands of the trustees or the beneficiary, depending on when it's distributed. Beneficiaries over 16 who receive income within six months of the end of the tax year pay personal tax rates. Unpaid income is taxed at the trustees' rate. The IRD has specific reporting requirements for trusts that came into effect in 2022. Trustees have limited powers and are bound by their duties, as outlined in the Trusts Act. These restrictions are based on the trust deed, legislation, and case law. Setting up a trust requires understanding its terms and limitations to ensure it meets your needs and won't be affected by clawback provisions. Consulting with a lawyer is advisable to establish a trust that fully meets your requirements and intended purpose. There are various types of trusts suitable for individual circumstances, including cross or mirror trusts, which can provide maximum protection without direct spouse involvement. Setting up multiple trusts instead of one can be a complex process, especially when it comes to family trusts. For instance, the first spouse could establish a trust with their partner, children, and grandchildren as beneficiaries. The second spouse could do the same, creating another trust with the same beneficiaries. However, it's essential to consult a lawyer to determine the type of trust you need, as trusts are subject to various legal requirements and provisions that can affect their purpose. A court may set aside transfers of assets made to defeat creditor or partner rights under the Property (Relationships) Act 1976. If a couple's relationship property is transferred into a trust, which defeats one partner's rights, the court might order the other partner to compensate them. Additionally, transferring assets into a trust can impact eligibility for residential care subsidies. It's crucial to assess whether a trust is suitable for your objectives and weigh the advantages and disadvantages of each option. You should also consider ongoing management and compliance costs. Your lawyer will help you determine what's required to meet your needs. Many people require legal assistance at some stage in their life, whether it's buying a home, drafting a relationship property agreement, or involving court proceedings. Feeling reluctant about contacting a lawyer for the first time is understandable; however, speaking with one sooner rather than later can often save you time and money while bringing valuable peace of mind. Find out more about choosing a lawyer and preparing for your first appointment. In Aotearoa New Zealand, anyone providing legal services must hold a current practising certificate issued by the New Zealand Law Society Te Kāhui Ture o Aotearoa to use specified terms like 'lawyer.' To find out if someone has a practising certificate, visit the New Zealand Law Society's website. You can search our lawyer register to find a qualified professional, but be aware that some advocates may provide misleading descriptions. Lawyers in New Zealand must follow strict rules of conduct and client care, which also apply to their interactions with courts and the justice system. When you first instruct a lawyer, they are required to provide you with important information about their fees, including how and when they will be paid. Ensure that your lawyer's fees are fair and reasonable. Review tips on discussing fees in advance, understanding how lawyers charge for services, tracking costs, and resolving disputes over bills. If you're concerned about your lawyer's behavior, consider contacting the Lawyers Complaints Service. Before making a complaint, it's best to raise your concerns with your lawyer first. They have a process for handling complaints and must inform their clients before starting work. Here are some tips for raising concerns: Legal aid may be available if you meet certain financial requirements. Your lawyer can inform you about potential eligibility, but they cannot work on legally aided matters. The Ministry of Justice provides free legal advice through the Family Legal Advice Service, which is available to those involved in parenting or guardianship disputes.